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THREE DOLLARS

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Forbes

**REAL ESTATE
SYNDICATION**

**WHEN WILL THE
BUBBLE BURST?**



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143 Cover Story: What's hot in tax shelters? Real estate syndication. So look out, brother.



39 Stockbrokers: It's not 1975 in New York, but 1983 in London.



67 Norfolk Southern Corp.: "A lot of security analysts get very impatient with us."

The editorial index of companies referred to in this issue is on page 246.

38 Leveraged Buyouts: "Mezzanine Financing"

Ever wonder why there are so many leveraged buyouts these days? Follow the money—and there is plenty of it in this business.

39 Great Britain: The Americans Are Coming!

And the end of fixed brokerage commissions can't be far behind.

41 Energy: The Propane Boom

Here's a corner of the energy business that isn't languishing.

42 Investments: The Japanese Connection

It's one reason Merrill Lynch's technology fund is doing well even though the market for technology stocks has peaked.

43 Investments: Dean LeBaron Of Batterymarch

The search for irrationality means buying Hong Kong real estate companies and utilities in Spain.

48 The Streetwalker: Murdoch In Tinseltown

Why is Rupert Murdoch buying into Warner Communications? One theory: He believes direct satellite broadcasting is the wave of the future. Also: Contrarianism in smokestack stocks; Dorchester Gas; Major Realty; Madison Fund; Xerox.

50 Statistical Spotlight: For Bargain Hunters Only

A lot of stocks were left behind in the bull market of 1983. Here, a roundup of some interesting distress merchandise.

52 Companies: American Telephone & Telegraph

With its U.S. business up for grabs, AT&T's Western Electric subsidiary is looking hungrily at the foreign phone market. But a lot has changed in the half century it has been away.

54 Leasing: The Return Of Single-Source Leasing

Another big change in the freight business—good for private shippers, bad for a lot of truckers—is just one court decision away.

58 Companies: Horn & Hardart

Barry Florescue, an old Burger King hand, has revived the old Automat chain.

67 Companies: Norfolk Southern

Why, you ask, is Bob Claytor sitting on all that cash—nearly \$1 billion of it? His answer is: Why not?

79 Numbers Game: Stunting Junior's Growth

Genentech discovered a hot new form of executive compensation—junior stock. But now, wouldn't you know it, the accountants may wind up throttling it.

82 Universities: Incubating Capitalists At RPI

Rensselaer Polytechnic Institute has begun to grow systematically what sprang to life naturally around MIT and Stanford.

96 The Up & Comers: Lamaur Inc.

Dick Spiegel would seem to have it made. So why is he betting the company in the classic way? Also: Helen of Troy; Kaepa; and a report on a study of rising executives' work habits.

107 On The Docket: What Is Fire Damage?

New building materials, especially those made with PVC, have greatly complicated once-straightforward questions about who is responsible.

110 Taxing Matters: Intercompany Pricing

The IRS attacks an old play with new vigor.

112 Asia: Confucian Capitalists

No one could have foreseen the Pacific Basin's present prosperity. But now, predictably, the area is spawning centimillionaires and even a few billionaires.

143 Cover Story: Have They Got A Shelter For You!

The present appetite for tax sheltered real estate deals (last year less than \$5 billion, this year \$8 billion) seems insatiable. But it can't—at least it shouldn't—last.



82 Venture Capital: Can a university serve as entrepreneurial incubator?



96 The Up & Comers: If he fails, a tarnished company. Ah, but if he succeeds...



112 The Pacific Basin: A prosperity no one could have predicted.



198 Parker Pen Co.: Jim Peterson had to bit the ground running.

158 Tax Shelters:

Emotion Versus Common Sense
Why do otherwise sensible people throw good money into bad shelter deals? Joe (The Wizard) Bianco knows.

167 Personal Affairs:

Toys Are You And Me
Electric trains may be losing favor with kids, but the ranks of senior model railroaders seem to be growing. Also: a further caution on tax shelters (December is the cruellest month); the opportunity cost of an M.B.A.

186 Technology:

Holography's Bright Future
The industrial potential of holography, a laboratory curiosity no more, is far from exhausted. Also: shark repellents; waste mismanagement; surveillance against shoplifting; high-pressure water technology.

198 Companies:

Parker Pen Co.
Its Manpower, Inc. subsidiary is doing fine. Now, with a little more pen power...

Faces Behind The Figures

- 204 Arnold Greenberg, Coleco Industries, Inc.
- 204 John Harvey-Jones, Imperial Chemical Industries
- 206 Ken Thompson and Joe Condon, Bell Laboratories
- 206 Joel Myers, Accu-Weather, Inc.
- 208 John Bryson, Southern California Edison
- 208 Bob Roth, Chicago Reader
- 210 Herbert Belkin, Mobile Fidelity Sound Lab

220 Statistical Spotlight: Shopping For A Bank?

A lot of foreign bankers are doing just that. Here's a shopping list.

226 Stocks: Collectors' Items

A railroad with no employees and other listed oddities that trade every day.

Money And Investments

- 33 What's Ahead For Business
- 34 The Forbes Index
- 215 The Forbes/Wilshire 5000 Review

Columnists

- 235 Ben Weberman
- 236 Srully Blotnick
- 238 Ann C. Brown
- 242 Stanley W. Angrist
- 244 Richard B. Hoey

Departments

- 6 Side Lines
- 8 Trends
- 14 Follow-Through
- 21 Readers Say
- 25 Fact and Comment
- 28 Other Comments
- 31 Fact and Comment II
- 247 Flashbacks
- 248 Thoughts

Photos:

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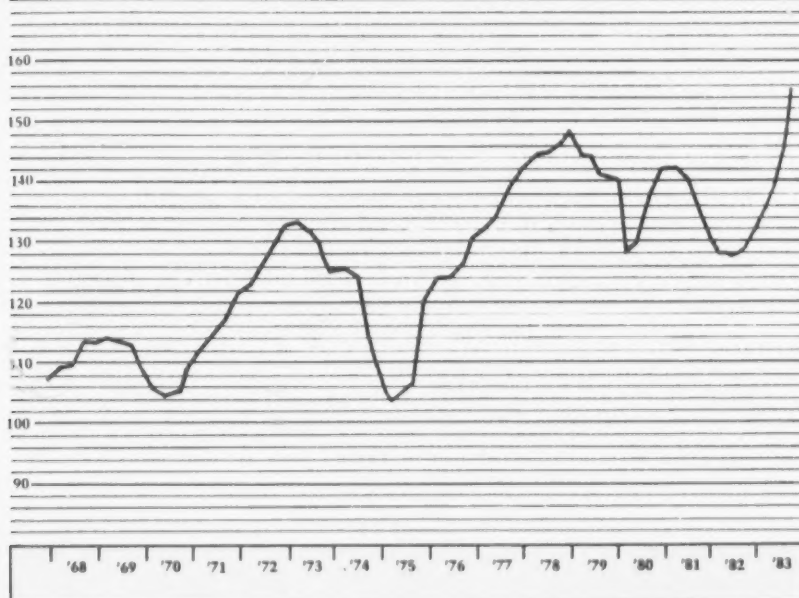
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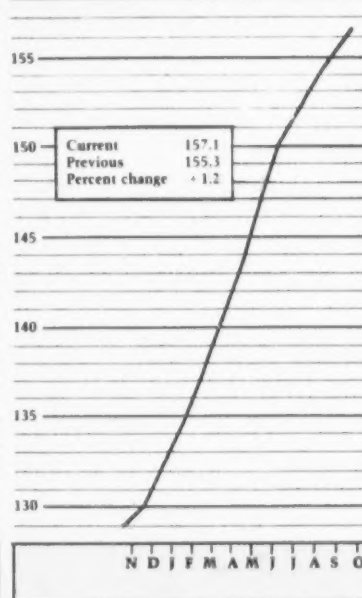
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The Forbes Index

Forbes Index



12-month close-up



Current	157.1
Previous	155.3
Percent change	+1.2

Controlled growth. With a 1.2% increase in the latest reporting period, the Forbes Index indicates that the economy is moving ahead but not overheating. The biggest month-to-month gains came in personal income and retail sales, up 1.2% and 1.1%, respectively. Will the holiday season at the checkout counter be as strong as some experts are expecting? While retail sales were 10.2% higher than a year ago, personal income is up only 8.9%. For a

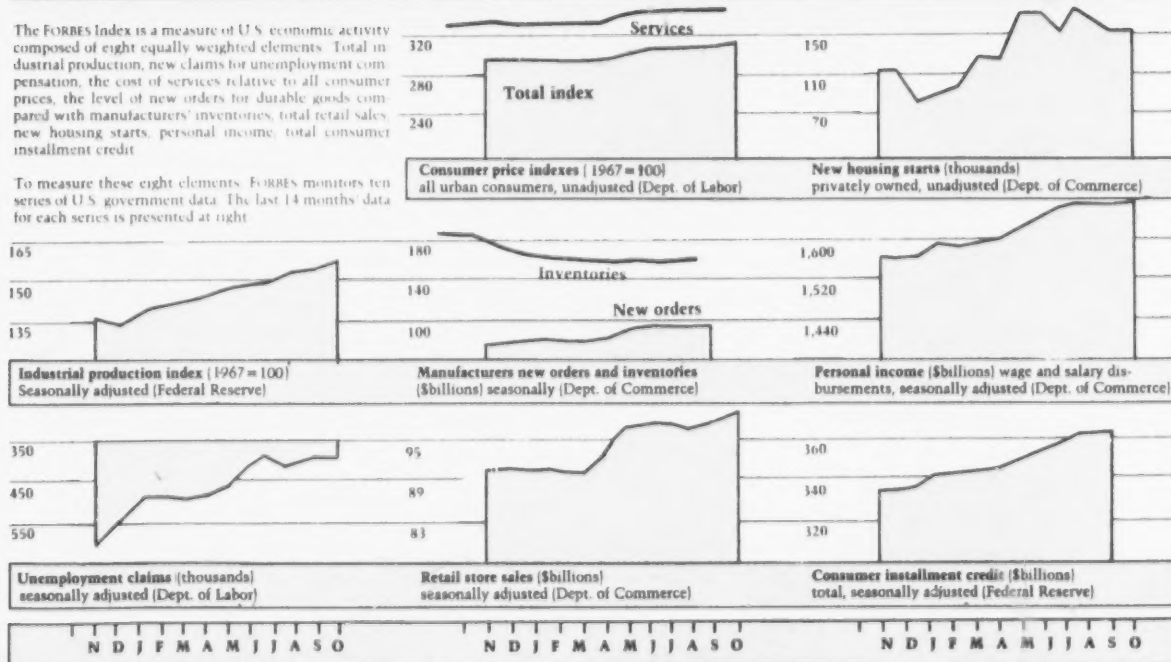
blockbuster Christmas, that means consumers must either dip into savings or take on more debt.

While a strong recovery in capital goods has yet to materialize, industrial production rose an encouraging 0.8% from the previous month. An advance in the consumer price index of less than 0.3%, meanwhile, translates into a 3.2% annualized rate of inflation. But there is bad news, too: a 2.6% gain in new unemployment claims.

The Forbes Index Components

The FORBES Index is a measure of U.S. economic activity composed of eight equally weighted elements. Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, FORBES monitors ten series of U.S. government data. The last 14 months' data for each series is presented at right.



Forget the ground floor. In leveraged buyouts everyone wants to get in on the mezzanine. Lots of action there.

Where the smart money wants to go

By Priscilla S. Meyer
and Robert McGough

EVER WONDER WHY there are so many leveraged buyouts these days? Sure, a lot of businesses are better run independently by owner-managers than by giant public cor-

porations. And there's the fact—well expressed by FORBES columnist Tom Murphy (Oct. 24)—that a lot of the LBOs are just being fattened up for a run at the new issues market. But follow the money—and there's plenty of money in this business—and you discover what Wall Street cheerfully

calls "mezzanine financing."

The mezzanine may not be the ground floor, but in some senses it's an even better place to get in on the leveraged buyout game. To understand what the mezzanine is, it is necessary to understand how these deals are structured. On the ground floor, of course, is the manager of the company. He gets a nice chunk of the equity, paid for mostly with the promise of hard work. On the second floor are the bankers and insurance companies that lend the money to pay for the leveraged buyout.

There's something for the people on every level. The chap on the ground floor gets a chance to be his own boss and to get rich. The second-floor lenders, meanwhile, charge interest rates that are up to 3 percentage points over prime. They also benefit from "point" equivalents, upfront charges, prepayment penalties and equity options. The security, what's more, isn't deep gas or Third World dreams, but plain old corporate assets—stuff a creditor can actually touch.

Most LBOs, however, need something else to make them go. That's where the mezzanine comes in. Corporate managers, the guys on the ground floor, typically make token capital contributions. They kick in perhaps \$2 million in a \$180 million deal, a mere 1%. But the banks and insurance companies want more than \$2 million in protection; they want \$30 million, say. So, more equity is needed—the so-called mezzanine level. It is usually senior to the tiny slice of management equity and takes the form either of preferred stock or subordinated debt.

Mezzanine lenders are nominally investment bankers. But the real money comes from wealthy investors, venture capital pools or pension funds. They usually wind up with between 20% and 70% of total equity—which they hope to be able to sell off later to the public.

As long as speculators have an appetite for new issues—even new issues of old businesses—the profits on the mezzanine can be fat indeed. William Simon's \$66 million killing in Gibson Greetings shows the potential in LBOs. "It's got to the point," says an investment banker, "that if a guy

Selling a piece of the pie

Since 1978 these 16 corporate divisions have been acquired through leveraged buyouts.

Original owner	Division sold	Buyout originator	Price (millions)
AMF	Harley-Davidson	management	\$ 75
Allied	Converse	management	100
Anchor Hocking	Anchor Glass Container	Wesray	65
Bestrice Foods	All-American Bottling	Forstmann Little	105
Bendix	American Forest Products	Kohlberg, Kravis	435
Continental Group	Teepak	Hillside Capital	105
Dart & Kraft	Thatcher Glass	Dominick Intl	140
Diamond Intl	Heekin Can	Wesray	80
FMC	PT Components	Kohlberg, Kravis	125
Foremost-McKesson	Foremost Dairies	management	65
Gulf & Western	New Jersey Zinc	management	50
Gulf & Western	Consolidated Cigar	management	120
National Steel	Weirton Steel	employees and Lazard Frères	385
Owens-Illinois	Lily-Tulip	Kohlberg, Kravis	150
RCA	Gibson Greetings	Wesray	80
Revlon	Alford Industries	Bear, Stearns	75

walks in here with \$2 million wanting some ground-level equity in an LBO, I tell him to go away. I don't need him. There's plenty of money walking around."

What's appealing about LBOs is that they don't require fancy products or brilliant growth prospects. "We're after dull and ugly companies," explains Gilbert Butler, a former Morgan Guaranty vice president who now heads Butler Capital Corp. His pride and joy is Hygiene Industries, the nation's largest shower-curtain maker, which Butler Capital helped buy from Nabisco in 1982.

This was a \$28.5 million deal, arranged by First Boston. Butler provided \$7 million in mezzanine finance, in return for preferred stock and subordinated debt. Along with that comes roughly 30% of the company's equity. But Butler gets even more. He earns a juicy 17% annually on his money and has three attractive options: He can sell his Hygiene shares to the public, to management or to an outside investor.

No wonder everyone now wants to do mezzanine financing. A client of Kohlberg, Kravis, Roberts & Co., a New York firm, for example, claims to have earned a 700% return on the buyout and subsequent public offering of Norris Industries. Kohlberg, Kravis now is raising \$1 billion to do even more LBO deals, and much of that money, no doubt, will be put into mezzanine financing. Merrill Lynch, meanwhile, is in the mezzanine business, as is Citicorp; Morgan Stanley is about to enter. Narragansett Capital, a \$113 million closed-end fund that trades over-the-counter, also provides capital for leveraged buyouts. Over the past two years, share prices have gone up 140%.

It's the old story. The profit potential of leveraged buyouts is so good that the dollars are starting to chase the deals. There are already telltale signs of trouble. Houdaille Industries, for example, the Fort Lauderdale-based machinery company that was bought out in 1979 in a transaction handled by Kohlberg, Kravis, is reportedly having difficulty earning enough money to justify a return to the public market. Then there is Brentano's. In 1981 managers bought this bookstore chain from Macmillan. Within a year Brentano's filed for protection from its creditors.

So the leveraged buyout phenomenon looks like it will go to extremes. It always happens that way in markets. So far, a lot of money has been made in LBOs. In the end a lot of money will be lost. ■

Selling the whole pie

Since 1978 these 20 corporations have been acquired through leveraged buyouts.

Company/business	Buyout originator	Price (millions)
Albany Intl/papermaking, fabrics	Morgan Stanley	\$270
Beverage Management/soft drinks	Forstmann Little	100
Cannon Mills/household textiles	Pacific Holding	405
Coca-Cola Bottling of Miami/soft drinks	investors	155
Coca-Cola Bottling of NY/soft drinks	Gibbons, Green	220
Congoleum/floor coverings	First Boston	460
Dan River/textiles	Kelso & Co	150
Dentsply Intl/dental, optical equip	Kelso & Co	115
Dillingham/maritime, constr, energy	Kohlberg, Kravis	350
Empire/liqefied petroleum gas distr	Allen & Co	115
Fred Meyer/food retailer, distributor	Kohlberg, Kravis	425
Marley/cooling towers	Kohlberg, Kravis	330
NI Inds/building products	Kohlberg, Kravis	420
Purez Inds/household cleaning prods	Gibbons, Green	390
Questor/infant feeding, seating equip	DW Lufkin	135
Raymond Intl/engineering, constr	Kelso & Co	155
Reeves Brothers/textile mfr	Bankers Trust	165
Reliance Group Holdings/fin svcs	Saul Steinberg	535
Signode/strapping sys fastener	Merrill Lynch	430
Williamhouse-Regency/sationery	Carl Marks & Co	115

In London's financial markets, the panic is beginning. Fixed brokerage commissions are going and . . .

The colonials are coming

By Marcia Beres

DÉJÀ VU: The stock exchange abolishes the fixed commission. Brokers wail that the increased competition will force them to merge or fold. Research analysts financed by fixed commissions worry about what will support their activi-

ties. Everyone says that the firms with the deepest pockets will dominate the marketplace.

It's not 1975 in New York but 1983 in London, and the British brokers are sweating. The deepest pockets belong to the Yanks, and they just might overrun the London Stock Exchange and turn the corner of Throgmorton

Nothing will open doors for you like an M.B.A. degree from a top school. Earning one is the quickest route to the fast track. Still, is it worth it?

What's an M.B.A. really worth?

By Maria Fisher

SHORT OF A Jr. after a name that is also on the headquarters building, they still say, no letters in the corporate world will do more for you than M.B.A. when it comes to starting salaries. A typical 1973 graduate of Harvard Business School started at \$17,000, for example. Five years ago the figure had risen to \$24,000. Last spring it stood at \$38,000; that's a jump of about 200% in a decade. Ayse Manyas Kenmore, Stanford's placement director, says that she expects salary offers to run \$70,000 to \$80,000 from consulting firms for next spring's graduates.

Eighty thou to start? Doesn't it figure to get that M.B.A. at all costs, from as good a school as will have you? Well, it's no longer that simple. For some would-be world-beaters, the

apparent value of an M.B.A. degree may be deceiving. Maybe the real cost is too high.

There are two reasons for this seeming paradox. First, most top schools now require "real world" experience before a student can even apply for admission. As a result, top-level undergrads who would normally go straight into graduate school first get a job. If they have potential, they will be moving up soon enough—without the M.B.A. Second, of course, is the substantial cost of attending school itself on top of the job income no longer coming in.

Look at the numbers. Suppose you are a bright young graduate of a top school—Harvard, for example. You want to go to the B-school, but you need to wait a year to apply. You keep your intentions to yourself and take a job with Happibank, starting at

Personal Affairs

Careers

\$25,000 per year. In six months you get a raise and a promotion, to \$30,000, and you are on a fast track. Suddenly, the B-school beckons.

If you go off to school for two years, you will lose at least \$60,000 in salary, not counting other raises and promotions that might have followed. Add to that about \$35,000 out-of-pocket for room and board, tuition, etc. So your true cost for the M.B.A. could approach \$100,000.

Upon graduation, of course, you could be able to command a starting salary of \$50,000 or more. But where would you be if you had stayed with Happibank in the first place? (And, if Happibank really liked you, they might even have been willing to pay you to get more training, perhaps even an M.B.A. part time, while you were still on the payroll.) Your hard-won M.B.A. in hand, you are gambling that over the years your M.B.A. will generate far more than the \$100,000 it cost you to get it.

But isn't the M.B.A. worth the most at the start of a career? After a year or two off the campus, you will be judged on performance, rather than on potential.

So, is the M.B.A. worth getting after all? Well, let's not get too hung up on numbers. Maybe two years in B-school will leave you knowing a good deal more than just what salary to expect upon graduation. ■

Talk about opportunity costs!

The market price on new M.B.A.s is rising as the effects of the recession fade. Here are current figures from 14 of the nation's better-known B-schools.

School	—Median starting salary— spring 1983 spring 1978		Applicants for admission 1983	Number admitted fall 1983	% men/ women	% with 1 or more years' work experience	Estimated annual expenses*
Carnegie-Mellon	\$32,748	\$21,000	902	127	80%/20%	60%	\$15,025
Chicago	34,762	20,128	3,206	478	79/21	74	15,600
Columbia	34,534	21,841	2,947	464	67/33	80	14,040
Dartmouth (Amos Tuck)	35,000	22,100	1,700	140	76/24	92	17,000
Harvard	38,000E	24,000	5,800	785	75/25	97	16,700
MIT	36,200	23,800M	1,445	193	73/27	80	17,950
Michigan	29,400E	20,178M	1,631	362	72/28	50	8,874/12,538†
NYU	30,600	19,700M	1,932	370	59/41	83	15,352
Northwestern	31,100E	20,100	3,043	450	67/33	83	16,200
Pennsylvania (Wharton)	37,854M	21,890M	3,400	610	72/28	97	16,000
Stanford	39,200E	24,000	4,686	316	75/25	93	16,600
Texas	27,027M	18,100E	1,788	642	67/33	under 15	5,610/6,900†
UCLA	32,713M	19,781	3,275	360	64/36	91	9,500/12,500†
Virginia	33,000	21,500	1,344	241	75/25	95	8,436/11,576†

*Includes tuition, room and board, fees, books and living expenses for a single student. †In-state student/out-of-state student. E: Estimate. M: Mean.